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California Brings $4B To Market

Despite Muni Losses, 36% of Rans Sold

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By Michael Scarchilli

A day after a historic stock market rally, and despite sharp losses in both Treasuries and municipals, California successfully brought $4 billion of revenue anticipation notes to retail investors yesterday.

The Golden State sold $1.465 billion of revenue anticipation notes or 36.6% of the deal.

Treasury and tax-exempt yields saw pronounced rises on this weekend's announcement that the U.S. government will provide a $250 billion capital injection to banks. Traders said tax-exempt yields were higher by 10 to 15 basis points, scattered along the curve.

However, in the new-issue market, Banc of America Securities LLC priced for retail investors $4 billion of revenue anticipation notes for California. This is the first of a planned two-day retail order period, to precede institutional pricing tomorrow. A total of $1.465 billion was sold to retail yesterday. A $1 billion piece matures in May 2009, yielding between 3.75% and 4.00% with a 5.5% coupon, while the larger $3 billion piece matures in June 2009, yielding between 4.25% and 4.50% with a 5.5% coupon. Orders comprised $268.2 million of the May 2009 maturity and $1.197 billion for the June 2009 maturity. The credit is rated MIG-1 by Moody's Investors Service, SP-1 by Standard & Poor's, and F1 by Fitch Ratings.

A trader in Los Angeles said the yield levels on the California deal will "restructure the whole short Cal market."

"That's what everyone has been waiting for. People are going to adjust their bid sides to get them," the trader said. "That deal should get done. That's less than a year paper. That's the best deal you can buy, the cheapest these guys have been able to see in months, or even years. If I had money, I'd buy it. Bonds are the best buy on the Street. You can't get that yield on any money market or anything. They should do pretty well with that."

According to Municipal Market Data, 30-year triple-A general obligation bonds were yielding in the range of the California deal's yields as recently as four and a half months ago, when they yielded 4.49% on June 4. As of Monday's close, the same bonds yielded 5.89%.

Howard Mackey, president of the broker-dealer business unit of Rice Financial Products, said that the market should be currently attractive to retail investors.

"These rates are just absolutely unbelievable, and on an after-tax basis, they are even better," he said. " So de minimis not withstanding, this is representing an extremely powerful opportunity to retail investors."

Mackey said this is particularly true in the secondary market, where "the more prevalent structures tend to be retail structures."

"You have 5% or higher coupons, at a discount anywhere from 18 to 20 years on out, so a lot of those coupons work well for retail," he said. "I think you'll continue to see some improvement here, but with retail, they tend to be a little less sensitive about the market. Particularly in terms of liquidity issues, so if they're buying to hold, and they buy a 10- or 15-year piece of paper, they're not really looking at what the bid-ask spread is on it the following day or the following week. So I would think you'll tend to see some interest there."

However, Mackey said, "the big problem that overhangs all of this is the fact that a lot of large institutional buyers are now starting to focus on potential problems that you might run into with municipalities, in terms of their own cash needs"

"A big case in point right now is California, in terms of just the decision-making process they are currently undergoing to determine how they might bring a $4 billion note deal to the market," he said. "With that type of concern overhanging the market, it's going to cause rates to back up quite a bit." Mackey also thinks the market will continue to see retail interest on the level of last week's Ohio deal, where Citi priced a $240 million offering for the state in which $180 million went to retail.

"In effect, there wasn't much of an institutional order period. I think you're going to continue to see that type of push, because people are seeing spreads against Treasuries that we've never seen in our history," he said.

As of Friday's close, according to MMD, 10-year triple-A municipal GO yields were 117% of comparable Treasuries, while 30-year triple-A tax-exempt yields were 146% of 10-year Treasury yields, ratios which Mackey terms "very compelling."

The Treasury market showed losses yesterday. Treasuries originally weakened after stock market gains, following stocks' massive rally Monday. However, the stock market gains faded as the session wore on, and the Dow Jones Industrial Average finished in the red, down about 77 points. The yield on the benchmark 10-year Treasury note, which opened at 3.98%, finished at 4.07%. The yield on the two-year note opened at 1.58%, and finished at 1.83%. And the 30-year Treasury bond, which opened at 4.13%, finished at 4.27%.

Matt Fabian, managing director at Municipal Market Advisors, agreed that the market now provides a good opportunity for retail buyers, but cautions that "retail is more susceptible to event risk."

"They don't want to see their issuers in the news. Retail investors are being paid very well, but they're also more nervous now than they've been in a long time," he said. "I would think that most retail traders will tell you that they're spending far too much time soothing their clients' concerns, as opposed to trying to gather assets and invest money."

Also yesterday, New York's Metropolitan Transportation Authority postponed its $500 million revenue bond deal, which JPMorgan was slated to price later this week, due to unfavorable market conditions.

"In light of continuing uncertainties in the credit markets, MTA has delayed progressing its planned $500 million issuance. We will be reviewing market conditions on a day by day basis," wrote Jeremy Soffin, deputy director of media relations for the MTA, in an e-mail.

Also, New York City postponed a planned $300 million GO sale due to market conditions. Morgan Stanley was slated to price the deal for retail investors yesterday and today, and hold an institutional pricing tomorrow.

"We wanted to assess the market tone and firmness after the long weekend and large volume of news," said Laura Rivera, spokeswoman from the city comptroller's office. "We are monitoring the market closely and will make pricing decisions on a day-to-day basis."

These postponements were the most prominent, but several other small deals were put on hold yesterday, recreating a trend which had endured for much of the latter half of September. On Sept. 12, the session prior to Lehman Brothers Holdings Inc. filing for bankruptcy, and Bank of America's purchase of Merrill Lynch & Co., 30-year triple-A GO bonds yielded 4.56%, according to MMD. As of Monday's close, the same bonds yielded 5.89%.

Since Sept. 18, 201 bond and note sales, both competitive and negotiated, totaling $11.25 billion, have been rescheduled for later dates, postponed indefinitely, or canceled outright. This is based on information compiled by The Bond Buyer from its offerings calendars.

Fabian said that the situation issuers face is "pretty hard," because they "pay a penalty when the market is volatile."

"That's regardless of the level of rates, just because bonds are much harder to price," he said. "So in a market like this, where you're trying to scrape every last bit of price out of a deal, from the issuer's perspective, it's probably best to wait until things settle down."